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No. 86-

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

CAMPBELL SALES COMPANY,

Petitioner,

vs.

NEW YORK STATE TAX COMMISSION,

Respondent.

PETITION OF CAMPBELL SALES COMPANY FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

GEORGE J. NOUMAIR*
ALLEN A. HANS
MICHAEL T. KIESEL

WHITMAN & RANSOM
Attorneys for Petitioner
200 Park Avenue
New York, New York 10166
(212) 351-3000

* *Counsel of Record*

QUESTIONS PRESENTED

1. Can New York, by requiring a combined return with an affiliated corporation not subject to New York tax, impose on a corporation a corporate income tax which is 58 times more than the tax would have been on a single corporation return basis without violating the "out of all appropriate proportion" to business transacted in the state test and the apportionment formula fairness test imposed by the due process clause of the United States Constitution?

2. Can New York impose its corporate income tax on income realized from the sale of goods shipped into New York which is exempt from state income tax under P.L. 86-272 (15 U.S.C. § 381) through the requirement of a combined return.

PARTIES TO THE PROCEEDING

The petitioner is Campbell Sales Company, Petitioner-Respondent below.*

The respondent is the New York State Tax Commission, Respondent-Appellant.

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* As required by Rule 28.1 of this Court's rules, Campbell Sales Company's parent corporation is Campbell Soup Company. Campbell Soup also owns all the stock of the following subsidiary corporations: Campbell Frozen Food Distributing Company; S.E. Wisconsin Products Company; Valley Tomato Products, Inc.; Campbell Soup (Sumter Plant), Inc.; Joseph Campbell Company; Champion Valley Farms, Inc.; Campbell Soup Inter-America, Inc.; Campbell Finance Corp.; Campbell Soup (Texas) Inc.; Godiva Chocolatier, Inc.; Herfy's Corporation; Lexington Gardens, Inc.; Pepperidge Farm, Incorporated; Pepperidge Farm Mail Order Company, Inc.; and Technological Resources, Inc; Toana Enterprises, Inc.

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(212) 351-3000

* *Counsel of Record*

OPINIONS BELOW

The decision of the New York State Court of Appeals denying petitioner's motion for reargument is reported at 68 N.Y.2d 808 (1986) and is reproduced as Appendix A at A-1. The order of the New York State Court of Appeals dated June 10, 1986,

is reproduced as Appendix B at B-1. The opinion of the New York State Court of Appeals is reported at 68 N.Y.2d 617, 505 N.Y.S.2d 54 (1986), and is reproduced as Appendix C at C-1 to C-7. The opinion of the Appellate Division of the New York State Supreme Court, Third Judicial Department, is reported at 111 A.D.2d 995, 490 N.Y.S.2d 313 (3d Dep't 1985), and is reproduced as Appendix D at D-1 to D-9. The order of transfer of the Supreme Court of the State of New York, County of Albany, dated October 28, 1983, is attached as Appendix E, at E-1 to E-2. The opinion of the State Tax Commission of the State of New York is reproduced as Appendix F at F-1 to F-12.

JURISDICTION

The decision of the New York State Court of Appeals, denying the motion of Petitioner for reargument, was rendered on September 9, 1986 (App. A, A-1). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

STATUTES AND REGULATIONS INVOLVED

Section 1, 14th Amendment to the United States Constitution provides:

> . . . [No] State [shall] deprive any person of life, liberty, or property, without due process of law.

Pub. Law 86-272, 15 U.S.C. § 381 provides:

> § 381. *Imposition of net income tax*
>
> *Minimum standards*
>
> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities

within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Domestic corporations; persons domiciled in or residents of State

(b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to —

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

Sales or solicitation of orders for sales by independent contractors

(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the

solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Definitions

(d) For purposes of this section —

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

STATEMENT

The Taxpayer and its Business*

Campbell Sales Company, Petitioner here, a New Jersey corporation, is a wholly-owned subsidiary of Campbell Soup Company. Since 1922 when it was formed, Campbell Sales has solicited sales for Campbell Soup. Campbell Sales has over 1,000 employees, all of whom work solely for it (except for its president who devotes full time to Campbell Sales but serves as a nominal vice-president of Campbell Soup). Such employees solicit orders, mainly from retail stores, for products of Campbell Soup and remit such orders to Campbell Soup for acceptance. If accepted, the orders are then shipped by Campbell Soup directly to the customer, which in turn pays Campbell

* References herein to the record are to the Record below, which has not been reproduced here because it is not believed that there are any material disputes with respect thereto.

Soup therefor. Campbell Sales is compensated by Campbell Soup for its selling services under a formula, which during the year involved gave Campbell Sales compensation — a commission — of 2.5% of sales generated by it. This sales commission is fair and reasonable in all respects; it is not less than and in all probability more than the equivalent of an arm's-length commission. The selling services performed by Campbell Sales for Campbell Soup are in all material respects the same as the services performed by numerous independent parties for services rendered to independent processors and manufacturers of food products. The food industry is generally structured with one or more layers of independent middlemen (representatives, brokers, distributors) between the processor/manufacturer and the retailer.

Such commission represents substantially all of the income of Campbell Sales. On the other hand, substantially all of the expenses of Campbell Sales, consisting principally of salaries to its employees (which salaries are among the highest in the business), office and equipment rents and related expenses, are all paid to unrelated third parties.

The net income of Campbell Sales, computed by taking its income reduced by its expenses, both as described above, is relatively high both as a percentage of sales and as a percentage of net worth. Any number of independent third parties would solicit sales for Campbell Soup on precisely the same basis as Campbell Sales.

Campbell Sales solicits sales in all of the continental United States and maintains offices in approximately 34 states, including New York. By virtue of its offices in New York, Campbell Sales is subject to New York State corporate income tax. Campbell Soup, on the other hand, has no offices, property or activities in New York, and it is not subject to New York State corporate income tax. Orders received from customers located in New York are accepted or rejected at the offices of Campbell Soup outside of New York, and, if accepted, goods are shipped, usually by common carrier, from its food manufacturing/processing plants outside of New York.

The New York State Corporate Income (Franchise) Tax

New York State imposes its corporate income tax on both corporations incorporated in New York and on non-New York corporations which do business there or which have an office or property in the State. With respect to corporations which have offices both within or without the State the tax rate is applied to a percentage of the entire net income of the corporation (which entire net income, with adjustments not here relevant is basically the same as income for Federal income tax purposes).

The New York percentage is the average of the percentages of:

(a) Property within New York to property everywhere;

(b) Payroll within New York to payroll everywhere; and

(c) Sales within New York to sales everywhere. With respect to sales, New York applies a destination test. All goods shipped from out-of-state to New York State customers are treated as New York sales (and goods shipped from New York State to out-of-state customers are treated as non-New York sales).

This three-factor formula is, however, modified by New York by counting sales twice (or double weighting sales) in arriving at an average percent. By way of example, if 2% of a taxpayer's payroll, 2% of its property and 8% of its sales were within New York, its apportionment factor under the three-factor formula and the New York formula would be as follows:

	3-Factor Formula	New York Formula
Payroll	2%	2%
Property	2%	2%
Sales	8%	8%
Sales	—	8%
	12%	20%
	÷3	÷4
Apportionment factor	4%	5%

To protect the revenue against distortions arising from transactions between and among related parties, New York State has the counterpart of Section 482 of the Internal Revenue Code. Section 211.5, N.Y. Tax Law (McKinney 1986), permits the State to adjust income and/or expenses on account of transactions between or among related parties which are not at the equivalent of arm's length or which result in a distortion of taxable income to which the above percentage is applied.

In addition to such provision, the New York State law also has a combined return provision, N.Y. Tax Law § 211.4 (McKinney 1986), which is applicable where one corporation owns more than 50% of the stock of another corporation and where more than 50% of its transactions are "intercompany". If all of the corporations fitting into this category are subject to New York tax (regardless of whether incorporated in New York), then the State Tax Commission (the administrator of the tax laws in New York) is permitted to mandate a combined return regardless of other factors.

If, however, one of the corporations is not subject to New York tax (as here), then, before a combined return can be required, there must be a finding *that a combined return is necessary to properly reflect the tax of the New York taxpayer on account of:*

> *(a) intercompany transactions; or*
>
> *(b) some understanding or agreement which distorts income or expense within the meaning of Section 211.5. N.Y. Tax Law*

If these threshold conditions have been met, the administrative regulations (not the statute) provide that if the businesses are unitary a combined return will be required. Because of these threshold conditions New York has not been regarded as a "unitary" tax state.[1]

---

[1] *See* Sec. 211.4(a) of the Tax Law (effective July 11, 1981 for taxable years *(footnote continued)*

The Controversy

For the taxable year ended July 31, 1977, after 35 years of reporting on a single corporation basis, the State determined that Campbell Sales must report on a combined return basis with Campbell Soup.[2] The basic New York tax (before surcharges and other adjustments not here relevant) on a single return basis and on a combined return basis are approximately as follows:

(footnote continued)

beginning on and after January 1, 1981), added by Ch. 484, Laws 1981, under which New York for the first time, we believe, imposed its corporate franchise tax on a unitary basis with respect to non-taxpayers, but limited its application to oil companies, as defined. This unitary tax on oil companies was repealed effective with taxable years beginning after December 31, 1983. Ch. 400, Laws 1983.

N.Y. Times, June 28, 1983, at A1, col. 5, attributed to Governor Mario Cuomo immediately after the United States Supreme Court issued its decision in *Container Corp. of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983), on June 27, 1983, the following position:

> "New York State . . . has applied a unitary tax only to oil companies."

And, in February, 1984, *The American Banker*, February 28, 1984, at 17 (IBA Special Section), reported that Governor Mario Cuomo has gone unequivocally on record as opposing (a unitary) tax.

Also see, Edward M. Griffith, Jr., "Is New York Moving Closer to a Unitary Tax System" 65 Journal of Taxation 360, (November 1986).

[2] For all prior years since 1941, when it commenced doing business in New York, Campbell Sales' New York tax was based on a modified formula (presumably under N.Y. Tax Law § 211.5) under an agreement reached with the New York State Tax Commission. For the immediately preceding years, the tax on the agreed upon basis was higher than the tax on a statutory formula basis. For years prior thereto, it is not known whether the tax was greater or less than the tax on a statutory basis. The origins of the agreement are not known, but both parties followed it consistently until the 1977 return. For the year 1977, the State rejected the agreement so that the tax here whether it be on a single or combined return basis is based on the statute without reference to any agreement.

Single corporation return	$ 10,559
Combined return	621,881

Set forth below are the payroll, property and sales amounts for New York and a determination of the New York apportionment factor on a single return basis:

Actual

	1 New York	2 Everywhere	New York (1) to Everywhere (2) %	
Payroll	$1,732,328	$16,672,740	10.39[3]	
Property	373,240	2,360,104	15.81[3]	
Sales	3,032,279	33,333,782	9.10	(Double
			9.10	Weight)
			44.40	
New York percentage		÷4	11.10	

The entire net income of Campbell Sales (after adding back taxes deductible for Federal but not for state purposes) was $951,000,[4] which, applying the New York base tax rate of 10% to 11.1% thereof would result in a tax of $10,559 (before surcharges). The actual tax determined on a combined return basis at the basic 10% rate (before surcharges) was $621,881. To arrive at a New York tax of $621,881 would require income apportioned to New York (at 11.1%) of $6,218,810 and an overall net income of Campbell Sales of a much greater amount — $56,025,310 — before apportionment. Since the expenses of Campbell Sales represent payments to unrelated third parties, the additional imputed net income must come from additional

[3] The record reflects that the New York percentages for payroll and property materially ex ceed the sales percentage because the cost of doing business in New York is generally and relatively higher than elsewhere in the United States. This would indicate that profits in New York are relatively lower in New York than in other states.

[4] Gross receipts of $33,333,782 less costs and expenses of $32,600,867 results in a net income of $732,915 for Federal income tax purposes; adding back state income taxes increases the net income to $951,237.

income must come from additional imputed gross income or sales commission to Campbell Sales from Campbell Soup, which in turn would translate into a commission of over three times a normal, reasonable arm's-length commission.

In short:

> — If the New York tax at the basic 10% rate is $621,000, then the New York income, using the New York apportionment factor, must have been $6,210,000.
>
> — If the New York income, which is 11.1% of the entire net income, is $6,210,000, then the entire net income must have been over $56,000,000.
>
> — If the net income were over $56,000,000 for the entire company and the expenses, all of which were paid to unrelated parties, are approximately $32,600,000, then the gross receipts must have been the sum of the two—or approximately $89,000,000; if the gross receipts are $89,000,000, the sales commission (the principal source of income) would have been over 6.6%, as opposed to the actual arm's-length equivalent sales commission of 2.5%.
>
> Thus, the effect of the combined return is to almost triple the gross income of Campbell Sales, and since the expenses — payments to unrelated parties— remain the same, the net income and resulting New York tax is increased by over 5,800%.

The assessment of the tax by New York allocated substantially all of the tax to Campbell Soup, a non-New York taxpayer and a minimum tax was assessed with respect to the other subsidiaries of Campbell Soup which had no connection with New York whatsoever.[5]

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[5] On appeal, the State, despite its regulation to the contrary, conceded that
(footnote continued)

Campbell Sales, pursuant to the procedures applicable to contesting tax determinations in New York State filed a petition with the New York State Tax Commission (which also administers the tax laws). Following a hearing, the State Tax Commission found that (F-4):

> A 2 to 2½ percent commission for the work which petitioner does is a fair and reasonable commission and is not less than, and is probably more than, the equivalent of the amount that would be paid for such work on an arm's length basis involving unrelated parties. For example, in 1977, petitioner paid its broker in Hawaii a 2 percent commission on the sale of Soup's products.

Then, after stating that the businesses of Campbell Sales and Campbell Soup were unitary, the Commission held (F-11-F-12):

> Where the businesses of corporations are so unified and interassociated (having due regard for their separate corporate existences), a proper reflection of *their* New York franchise tax liability is impossible without combination. (emphasis supplied)

There was no factual testimony or other evidence bearing on this conclusion and essentially it is a conclusion of law, not fact. The Tax Commission did not address the contentions made by Campbell Sales that the tax as so determined on a combined return basis was "out of all appropriate proportion" to the business and activities of Campbell Sales in the State and therefore, violative of the United States Constitution, and that the tax was in substance a tax on Campbell Soup and, among other things, violated the provisions of P.L. 86-272, 15 U.S.C. § 381 *et seq.*

(footnote continued)
it had no jurisdiction to impose its minimum tax of $250 on the subsidiaries which were not otherwise subject to New York tax (except by virtue of being included in a combined return).

Under New York State procedures, the determination of the State Tax Commission was appealed by Campbell Sales to the Supreme Court (Appellate Division, Third Department) on the record made before the Tax Commission; a *de novo* trial is not permitted. The Appellate Division in a 3-to-2 decision annulled the determination of the Tax Commission, holding as follows (11 A.D.2d, 998):

> It is obvious that respondent, by its determination, is endeavoring to tax the business activities of Campbell Soup in addition to the activities of petitioner.
>
> As a general principle, a State may not tax value earned outside its borders * * *. The broad inquiry in a case such as this, therefore, is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return" (*Asarco, Inc.* v *Idaho State Tax Comm.*, 458 US 307, 315 [citations and footnote omitted]).

The due process clause of the 14th Amendment requires that there be "a rational relationship between the income attributed to the State and the intrastate values of the enterprise" (*Mobil Oil Corp.* v *Commissioner of Taxes*, 445 US 425, 437). " [T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated (*Container Corp.* v *Franchise Tax Bd.*, 463 U.S. 159, 169). Where a taxpayer can prove by clear and cogent evidence that the income attributed to a State is in fact out of all appropriate proportions to the business transacted in that state, the taxing authority's determination will not be permitted to stand (*id.*). Petitioner has met that burden here, while the formula used by respondent to determine petitioner's franchise tax liability under the combined

> reporting method is unsupported by substantial evidence in the record.

The State then appealed to the Court of Appeals, the highest court in New York, which reversed the Appellate Division and reinstated the decision of the Tax Commission in a 6-to-1 decision. The Court of Appeals indicated that, where a corporation subject to New York tax (here Campbell Sales) is part of a unitary business with a corporation which is not subject to New York tax (Campbell Soup), a combined return can be required of the former if the stock ownership and intercompany transaction tests are met. In reaching this conclusion, the Court did not refer to or discuss the two further threshold tests imposed by the New York statute relating to mandating a combined return with a non-New York taxpayer such as Campbell Soup (improper reflection of tax on account of intercompany transactions *or* an agreement which distorts income) but then added (68 N.Y.2d, at 620):

> In any event, the State Tax Commission here expressly found that "a proper reflection of * * * New York franchise tax liability is impossible without combination." This conclusion is plainly rational.

The ellipsis — the deletion of the word "*their*" — was unexplained by the Court of Appeals. It is clear, however, that the State Tax Commission's use of the word "their" referred to Campbell Soup *and* Campbell Sales. This conforms to the view of the State that, by virtue of the combined return provision, it is entitled to levy a tax on Campbell Soup, which is concededly not subject to New York tax.

As with the Tax Commission decision, but unlike the New York Appellate Division opinion, the Court of Appeals did not address the contention of Campbell Sales that the tax on a combined return was "out of all appropriate proportion" to the activities of Campbell Sales in New York in violation of the United States Constitution; also it did not address the question of whether P.L. 86-272 was being plainly violated.

Campbell Sales then filed a motion for reargument, again stressing, among other things, the Constitutional limitations on taxation on a unitary basis where the tax is "out of all appropriate proportion" to the activities in the State. The motion was also based on a decision of the State Tax Commission issued *after* the argument in Court of Appeals in this case, which decision appeared on its face to be directly contrary to the views of the Tax Commission and the Court of Appeals in this case. More particularly, in *Boehringer Ingelheim Pharmaceuticals, Inc.* (TSB-H-86(5)(C) (April 30, 1986)), a New York taxpayer and its non-New York affiliate, which was not subject to New York tax, met the stock ownership and intercompany transactions tests. Despite the similarity of the material facts, the Tax Commission in *Boehringer* held that the test of whether a combined return would be required was whether the related company transactions tended "to distort or shift petitioners [New York taxpayer's] income", and concluded that, even though the 50% ownership and intercompany transactions were met, the intercompany transactions were basically fair (as in *Campbell Sales*) and that as a result a combined return was not required (unlike *Campbell Sales*). Despite this clearly inconsistent treatment of similarly situated taxpayers by the State Tax Comission, the Court of Appeals rejected without stated reason the motion for reargument. *See* A-1. This petition followed.

REASONS FOR GRANTING THE WRIT

I. PRELIMINARY

We recognize that where a corporation subject to the taxing power of a state is doing business both within and without the state, a state has wide discretion in applying apportionment formulas and there must be clear and cogent evidence that a state tax results in taxing extraterritorial values before it will be deemed to violate the constitutional requirement of "fair apportionment".

In determining the overall activities and income of a corporation, the state may base its apportionment on the unitary

business principle and under that principle may even require a corporation to report income of affiliated corporations not otherwise subject to the state's taxing jurisdiction. This may be accomplished through several methods, including a combined or consolidated return. The use of a combined or consolidated return is, however, merely a mechanism for measuring the tax to be imposed on the corporation in the combined group which is otherwise subject to the taxing jurisdiction. It does not expand jurisdiction so as to permit a tax to be imposed on a corporation not otherwise subject to tax.

While the New York statute does not profess to embrace the unitary principle, its regulations do so *once the statutory requirements* for a combined return are met. In the opinion below, the highest court of New York has in substance ignored the threshold statutory requirements applicable to a combined return including a non-New York taxpayer and has stated that it is "impossible" to determine the true income of a single corporation which is part of a unitary group without a tax computation on a combined basis. While we vigorously disagree with New York's interpretation of its own statute, we nevertheless do not contest that interpretation of New York law here, since the New York Court of Appeals presumably has the final word as to New York law.[*]

What we do contest here is the effect of the decision below — a tax which is 58 times more than the tax on a single corporation return — which, in both form and substance, permits New York to:

> (i) impose a tax on Campbell Soup, which, concedely, is not subject to New York taxing jurisdiction; or, alternatively
>
> (ii) impose a tax on Campbell Sales, a New York taxpayer, which is "out of all appropriate proportion"

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[*] As to New York law, we generally share the view expressed in the dissenting opinion of Judge Kaye of the New York Court of Appeals in this case which spells out in detail the material flaws in the reasoning of the majority.

to the business done by that corporation in New York; and

(iii) ignore the fairness test essential to permissible apportionment principles.

This result is arrived at solely through the misapplication of the combined return mechanism/unitary tax principles and a complete disregard for the principles imbedded in P.L. 86-272.

With respect thereto, it is respectfully submitted that:

1. The unitary tax principles set forth in *Container Corporation of America* v. *Franchise Tax Board*, 463 U.S. 159,169 (1983) and prior cases need clarification as to their use in expanding the taxing jurisdiction of a state through the means of a consolidated or combined return, so as to in substance permit a tax on the income of a corporation not otherwise subject to tax (rather than provide a new measure of income of a corporation otherwise subject to tax.)

A tax which is 58 times greater would seem under any rational standard to be "out of all appropriate proportion" to the business done within the state. Yet, the fact that the highest court of New York does not even address this and the fair apportionment issue, which were clearly raised and formed the basis for the holding of the intermediate appeals court in New York, is cogent evidence that New York either does not understand or rejects the limitations expressed in *Container Corp.*, *supra*, on the use, through a combined return, of the unitary method of determining income subject to apportionment and the "fair" apportionment thereof.

2. The result in this case clearly circumvents the principles established in P.L. 86-272, which forbids a state from imposing its income tax on a corporation whose activities with respect to such state are limited to shipping goods into such state where the orders therefor were accepted out of the state and whose activities are limited to solicitation in the state. This point, we believe, gives rise to an important case of first impression before this Court.

II. THE TAX HERE — 58 TIMES MORE THAN THE TAX ON A SINGLE CORPORATION BASIS — IS IN SUBSTANCE ON CAMPBELL SOUP; OR, IF ON CAMPBELL SALES, IS OUT OF ALL APPROPRIATE PROPORTION TO THE BUSINESS TRANSACTED BY IT IN NEW YORK.

The New York corporate income tax as determined herein on Campbell Sales is close to 100% of Campbell Sales actual income on a separate company basis, even though Campbell Sales is a national organization with offices in at least 34 states and, accordingly, is subject to and pays taxes in many states.[8] Under the standard New York apportionment formula, approximately 11% of its business is in New York and on a single corporation basis would pay New York tax on 11% of its income. Thus, it is obvious that New York with a 10% tax rate (before surcharges) is taxing much more than any fair share of the income of this corporation, regardless of what standard is applied. In the words of the New York Supreme Court, Appellate Division, the tax is clearly "out of all appropriate proportion" to the business done by Campbell Sales in New York (D-5-D-6).

The New York State Tax Commission, the administrator of the New York tax law and the finder of the facts here, held that the commission income of Campbell Sales derived from Campbell Soup is a fair and reasonable amount and is not less than, and is likely more than, the amount that would be paid to it on an arm's-length basis by an unrelated party. (F-4).

In these circumstances and again as found by the Appellate Division in New York, the tax in substance is a tax on Campbell Soup, which is not in and of itself subject to the taxing jurisdiction of New York. (D-5-D-6) If in form the tax were on Campbell Soup even New York would not try to impose it. Indeed, the State Tax Commission reversed its own internal determination which allocated the tax to Campbell Soup and instead

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[8] An issue substantially similar to the one here arose under the Georgia law which, although worded differently, was substantially the same as New York law. In *Blackmon v. Campbell Sales Corp.* 125 Ga. App. 859, 189 SE 2d 474 (1972) the highest court in Georgia held in favor of Campbell Sales on the ground that there was no distortion of income of Campbell Sales on account of intercompany transactions.

assessed the tax against Campbell Sales. Thus, the question is whether through the device of a combined return this additional tax can be levied on Campbell Sales where it clearly appears to well exceed the limits expressed in *Container Corp.*, where this Court stated (463 U.S. 159, 183-184):

> Of course, even the three-factor formula is necessarily imperfect. But we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by appellant. Indeed, it would be difficult to come to such a conclusion on the basis of the figures in this case: for all of appellant's statistics showing allegedly enormous distortions caused by the three-factor formula, the tables we set at nn ll-l2, *supra*, reveal that the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately l4%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business. *See also Moorman Mfg. Co.*, 437 US, at 272-273, 57 L Ed 2d 197, 98 S Ct 2340; *Ford Motor Co.* v. *Beauchamp*, 308 US 331, 84 L Ed 304, 60 S Ct 273 (1939); *Underwood Typewriter Co.*, 254 US, at 120-121, 65 L Ed 165, 41 S Ct 45.

In particular, in *Container Corp.*, the difference in tax on a separate basis and on a unitary basis which the Court upheld was as follows (463 U.S. at 174-75, n. 11 & 12):

	Separate Company	Unitary	Difference Amount	%
1963	$163,172.01	$178,476.88	$15,304.87	8.57
1964	168,422.14	202,310.95	33,888.81	16.70
1965	178,476.88	197,340.70	18,820.41	9.50

In the case of *In re Wurlitzer v. State Tax Comm'n*, 35 N.Y.2d 100 (1974), the case relied upon by the New York Court of Appeals in reaching its decision below, the tax increase on account of combining the non-New York taxpayer with the New York taxpayer was approximately 20%[9] On the other hand, in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931) cited with approval by this Court in *Container Corp.*, the increase of 250% was held to be objectionable.

Despite these precedents and the fact the tax here is 58 times greater than the tax on a single return basis and 23 times more than the increase which the U.S. Supreme Court rejected in *Han Rees*, the highest court of New York declined any comment on the constitutional issue raised below and which formed the basis of the decision of the Appellate Division, the second highest court in New York, in favor of Campbell Sales.

Rather the Court of Appeals relied upon and agreed with the statement of the Tax Commission that where the businesses are unitary, it is "impossible" to determine the tax liability of the two companies without a combined return.

As noted earlier, this is a finding of law, not of fact. Indeed, no evidence whatsoever was produced by the State or by the taxpayer which would support the conclusion that it was "impossible" to properly reflect tax absent a combined return. In particular, the evidence in the case found by the Tax Commission was that the only intercompany transactions involved were on the equivalent of an arm's length basis. In fact, the amounts paid by Campbell Soup to Campbell Sales were found by the

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[9] See, Tax Commission's brief (p. 5) in the *Wurlitzer* case in the Court of Appeals (35 N.Y.2d 100) where it indicated that the taxes involved were as follows:

	Separate Company	Combined Return	Difference Amount	%
1963	$41,935.19	$50,845.28	$ 8,910.09	17.52
1964	40,503.69	49,581.71	9,078.02	18.31
1965	34,756.26	46,012.87	11,256.61	24.46
1966	47,593.67	58,230.68	10,637.01	18.27
1967	39,587.57	47,408.33	7,820.76	16.50

Tax Commission to be probably more than what would be required on an arm's-length basis. Since the expenses of Campbell Sales were all to unrelated parties, it is clear that the apportionment of Campbell Sales' income only would result in a fair apportionment. That is not to say that there are not other methods of apportioning income, which may also be fair. It is quite another thing, however, to say, in the face of the clear evidence in this case, that the *only* method of determining fair apportionment is on a unitary basis, particularly where the result, as here, produces a tax which is 58 times more than the tax would be on the apportionment of a single company's income. In light of this Court's guidelines, set forth in *Container Corp.*, *supra*, it seems clear that this result, as mandated by the court below, well exceeds any fair apportionment.

The complete failure of both the New York State Tax Commission, the administrator of the tax laws, and the New York Court of Appeals, the highest court in New York, to recognize any limitations imposed on the use of the unitary tax method, in our view demonstrates either an impermissible rejection of those limitations or a complete misunderstanding of such limitations, which in the interest of the sound administration of important tax laws having broad impact both in New York and throughout the country, we respectfully submit, should be reviewed by this Court.

III. THE APPORTIONMENT FORMULA USED BY NEW YORK HERE DOES NOT MEET THE FAIRNESS STANDARD IMPOSED BY *CONTAINER CORP.*

The touchstone of apportionment is fairness. As stated by this Court in *Container Corp.* (463 U.S. at 169-70):

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency — that is the formula must be such that, if applied by every jurisdiction it would result in no more than all of the unitary business's income being taxed. The second and more difficult requirement is what might be called external consistency

> — the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State . . ." *Moorman Mfg. Co.*, *supra*, at 272 (emphasis added). *See Underwood Typewriter Co.*, 254 U.S. at 120-121. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.' [*Hans Rees' Sons, Inc.*] 283 U.S., at 135, or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 326 (1968)]." *Moorman Mfg. Co.*, *supra*, at 274.

The notion that it is "impossible" to determine the tax of a corporation which is part of a unitary group other than on a combined return basis is simply not rational,[10] particularly in a case such as here where the only element that might give rise to distortion or shifting of income — intercompany transactions (the commission paid by Campbell Soup to Campbell Sales) was held to be fair and reasonable and not less than and probably more than the equivalent of an arm's-length commission. Thus, it is essential that the holding below be tested against the fairness doctrine set forth in *Container Corp.*, *supra*.

As to internal consistency, obviously, the double-weighting of sales by New York,[11] violates the intent and very nature of the internal consistency rule in the sense that unless the same formula (double weight of sales and destination test) were

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[10] Indeed, the learning of *Container Corp.* is that there are numerous permissible ways of determining income on an allocated or apportioned basis.

[11] The New York State Assembly Rules Committee memorandum in support of the "double weight" legislation in 1976 indicated that "double

(footnote continued)

applied by every jursidiction, much more than all of the unitary business income would be taxed. In this regard it is believed that only four states double weight sales.

As to the second factor – external consistency – again, the application of the New York formula as applied here does not actually reflect a reasonable sense of how income is generated. The record reflects that the application of the New York formula attributed 36% of the worldwide income of all of the Campbell Soup group of companies to the selling company, and if one just considered the several subsidiaries combined by New York, that percentage would rise to approximately 50%. To say that 36% to 50% of the net income of an integrated food manufacturing/processing business, such as that of Campbell Soup, is attributed to the sales solicitation factor and only the remainder to research, testing, growing, manufacturing, processing, advertising, marketing and distribution is contrary to any real sense of how income is generated. It fails to recognize that Campbell Sales is profitable on an arm's length basis and that the location of Campbell Soup's activities outside of New York has nothing whatever to do with taxes any more than the location of the Taylor Winery or Eastman Kodak in New York is attributable to taxes.

In this regard, it must be pointed out that the general rule is that the mere shipment of goods into a state is not sufficient to generate a tax unless the shipper is also otherwise subject to the taxing jurisdiction of the state. This is the rule for Federal income tax purposes. It is the rule of most foreign countries. It is a rule of every state of which we are aware. Billions of dollars of goods are shipped into New York and other states by corporations not otherwise subject to tax in such states and which do not become taxable in the destination state or jurisdiction

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(footnote continued)
weighting" will enhance the State's business climate by reducing taxes for companies shipping out of New York. Conversely, it would increase taxes for companies shipping into New York. New York changed to a destination test for sales in the 1960's, presumably for similar reasons.

by virtue of such shipments. (Further, such rule is imbedded in Public Law 86-272, which in substance is the next major point in this petition).

In any event, it would seem it is apparent that New York has made its decision without reference to the rule that fairness governs apportionment. A clarification by this Court as to the obvious importance of the rule is, we respectfully submit, essential to a rational implementation of unitary tax principles in the context of business as actually conducted.

IV. THE TAX HERE IS IN CONTRAVENTION OF PUBLIC LAW 86-272, 15 U.S.C. § 381.

The additional tax in this case is caused primarily by the receipts or sales factor and, more particularly, by inclusion of goods shipped by Campbell Soup from outside New York to customers in New York as New York sales for the purposes of the New York apportionment factor. Yet, it is those very same sales which cannot be the basis for a tax by New York by virtue of Public Law 86-272, 15 U.S.C. § 381. As indicated above, that law prohibits a state from imposing a franchise tax on account of salesmen soliciting orders within the State. Campbell Soup does not even go so far as having salesmen solicit orders in New York State and is clearly protected by Public Law 86-272.

The recognition that Public Law 86-272 overrides the state franchise tax statutes, particularly in unitary tax cases, is nowhere more evident than in the landmark *Joyce* case, (*In re Appeal of Joyce, Inc.*, 1966 Calif. St. Tax Rep. (CCH) ¶ 203-523, p. 13,115 (California State Board of Equalization) in California, perhaps the leading unitary tax state.

In *Joyce*, *supra*, the taxpayer, a shoe manufacturer, was a California corporation subject to California tax under the standard three-factor formula. During the years in question, U.S. Shoe Company, a non-California corporation not otherwise required to file a return in California, owned substantially all of

Joyce's stock. U.S. Shoe's operations were outside of California, but it did have sales representatives who solicited orders in California. The California State Board of Equalization agreed with the Franchise Tax Board that the operations of Joyce and U.S. Shoe were unitary. The Board then stated (pp. 13, 117-118):

> While appellant [Joyce] operated as part of a unitary business and a formula method of allocation was therefore required, we still must determine whether respondent [the State], by its method of applying a formula, made a reasonable determination as to the amount of appellant's income attributable to California and includible in the measure of the franchise tax.
>
> Power to apply formula allocation pursuant to Section 25101 of the Revenue and Taxation code is not authority to tax a group of corporations as a unit or to include all of the California income in the measure of the tax of one of the corporations. The power is given to ascertain the income of a particular taxpayer within this state. (*Edison California Stores, Inc.* v. *McColgan*, supra) Accordingly, where two or more entities conduct a portion of a unitary business in the state it is necessary after the portion of the income from the unitary business attributable to the state is determined to make a further apportionment between the entities of the group to determine the tax liability of each. In many instances the apportionment between the taxpayers within the state is unimportant since the tax in total amount is the same, and the persons in control of the unitary business are not economically affected by the method of, or lack of, that apportionment. One instance, however, where the further apportionment is important is where the taxpayers fall into different categories. (Altman and Keesling, *Allocation of Income in State Taxation*, (2d ed. 1950) pp. 176-177.)

Pursuant to Pub. L. No. 86-272, no state has the power to impose a tax on or measured by income derived within the state by any person if the only business activities within the state are the solicitation of orders for sales of tangible personal property, which orders are sent outside the state for approval or rejection and if approved, are filled by shipment or delivery from a point outside the state. Specifically excluded by this federal statute from this immunity are corporations incorporated in the state where the activity occurs. Accordingly, the net income which appellant [Joyce] as part of the unitary group derived from sources within this state was includible in the measure of tax, whereas the net income of U. S. Shoe derived from sources within this state was not includible.

Inasmuch as U.S. Shoe, in addition to appellant, solicited orders in California, a portion of the unitary income attributable to sources within this state constituted income of U.S. Shoe which was not includible in the measure of tax. The apportionment of the California income between appellant and U.S. Shoe was not made by respondent.

We conclude that respondent must allocate to appellant and include in the measure of tax only a reasonable portion of the unitary net income which respondent has determined is attributable to California sources. This allocation should be made on the basis of appellant's property, payroll and sales within California, in a manner designed to reasonably reflect the contribution of those factors to the total unitary income. (emphasis supplied)

The State Board reasoned that Public Law 86-272 protected U.S. Shoe and its income from California's taxing jurisdiction and, in substance, held that the portion of the combined unitary income apportionable to U.S. Shoe was beyond the taxing jurisdiction. *Id.*

The situation here is basically the same. It seems clear that the income attributable to Campbell Soup is beyond the reach of New York State, whether by reason of elemental rules of jurisdiction, or, by virtue of Public Law 86-272.

We respectfully submit the holding below conflicts directly with the holding in the *Joyce* case and is an important case of first impression for this Court. As far as we are aware, Public Law 86-272 has never been interpreted by this Court in the context of unitary taxation, even though it is the only attempt by Congress, we believe, to limit the taxing authority of the states. With the increased interest in the states in imposing taxes on a unitary basis following the broad approval of unitary taxation in *Container Corp., supra*, the importance of the relationship between taxation on a unitary basis and the limitations thereon imposed by Public Law 86-272 is evident.

Just as importantly, the recent drastic reduction in Federal income tax rates is forcing every state to carefully examine its own tax structure. Every state is under pressure to reduce its own income tax rates so as to avoid windfalls (caused by the broadening of the federal tax base) and keep the net tax cost to the corporate taxpayer approximately the same—as the President and the Congress have said—revenue neutral. To accomplish this, however, any reduction in rates must be accompanied by a broadening of the base. With these twin pressures to lower the rate and to broaden the tax base, it is essential that the states understand fully and clearly the restrictions on state income taxation of multi-state enterprises imposed by the United States Constitution and the laws passed by Congress.

New York by virtue of the decision of its highest court obviously either does not understand such restrictions or does not recognize them. While we agree that legitimate parochial interests of New York, probably the most important commercial and financial state in the country, must and should be accommodated, it should not be at the expense of legitimate Federal Constitutional and statutory limitations.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE J. NOUMAIR
ALLEN A. HANS
MICHAEL T. KIESEL

WHITMAN & RANSOM
200 Park Avenue
New York, New York 10166
(212) 351-3000
Attorneys for Petitioner
Campbell Sales Company

Dated: December 8, 1986

APPENDIX

Court of Appeals of the State of New York

Mo. No. 813

In the Matter of
CAMPBELL SALES COMPANY,
Respondent,

vs.

NEW YORK STATE TAX COMMISSION,
Appellant,

Motion for reargument denied, with twenty dollars costs and necessary reproduction disbursements.

DECISION COURT OF APPEALS
SEPTEMBER 9, 1986

State of New York
Supreme Court—Albany County

CAMPBELL SALES COMPANY, *Petitioner-Respondent,* -against- NEW YORK STATE TAX COMMISSION, *Respondent-Appellant,*	JUDGMENT INDEX NO. 13900-83 DOL NO. 83015750

The Respondent-Appellant herein, represented by Robert Abrams, Attorney General of the State of New York, State Capitol Building, Albany, New York 12224, having appealed to the Court of Appeals of the State of New York from an Order of the Appellate Division—Third Department entered June 21, 1985, which annuled a determination of respondent which sustained a franchise tax assessment imposed under Tax Law Article 9-A, and the Court of Appeals, after due deliberation, having rendered a decision on the 3rd day of June, 1986, ordering that the judgment so appealed from be reversed, with costs, and the determination of the Tax Commission be reinstated, the Remittitur from the Court of Appeals having been filed in the office of the Clerk of Albany County, it is hereby,

ADJUDGED, that the aforesaid Order of the Appellate Division—Third Department be, and the same hereby is reversed, and the determination of the Tax Commission reinstated, with costs of $1057.00 to be taxed against the Petitioner-Respondent, whose address is Box 391, Camden, New Jersey 08101, in favor of Respondent-Appellant, and that the Respondent-Appellant have execution thereon.

/s/ MARIE A. REILLY
Deputy County Clerk

DATED AND ENTERED:
6/10/86

MEMORANDUM

This memorandum is uncorrected and subject to revision before publication in the New York Reports.

State of New York Court of Appeals

No. 145
In the Matter of
CAMPBELL SALES COMPANY,
Respondent,
v.
NEW YORK STATE TAX COMMISSION,
Appellant,

(145) Robert Abrams, Attorney General (Francis V. Dow, Robert Hermann, & Peter H. Schiff of counsel) for appellant,

George J. Noumair, Gerald D. Groden, & Allen H. Hans, NY City, for respondent.

MEMORANDUM:

The judgment of the Appellate Division should be reversed, with costs, and the determination of the New York State Tax Commission reinstated.

We agree, for the reasons stated in the dissenting memorandum of Justice Paul A. Yesawich, Jr. at the Appellate Division, that substantial evidence supports the determination of the State Tax Commission to require petitioner to file its franchise tax return on a combined basis with its parent corporation and other subsidiaries of the parent corporation. In order to accurately reflect tax liability, corporate taxpayers subject to

the New York State franchise tax may be required, in the discretion of the State Tax Commission, to file combined reports with other corporations, irrespective of whether such corporations are doing business in this State, where the parent owns or controls substantially all the capital stock of petitioner (*see*, 20 NYCRR 6-2.2[a], and the corporations are, in substance, part of a unitary business conducted by the entire group of corporations (*see*, Tax Law § 211[4]; *Matter of Wurlitzer Co. v State Tax Comm.*, 35 NY2d 100; *Matter of Coleco Inds. v State Tax Comm.*, 92 AD2d 1008, 1009, *affd.* 59 NY2d 994, 20 NYCRR 6-2.5[a]). Nevertheless, as we made clear in *Matter of Wurlitzer Co. v State Tax Comm.*, (*supra*, p. 105), "it is not a condition precedent that the income or capital of the taxpayer be improperly or inaccurately reflected" before the Commission may exercise that discretion and require combined reports because of intercompany transactions. In point of fact, many of the same arguments advanced by the dissent here were made by the dissenters in *Wurlitzer* and rejected by the majority. Our construction of the statute in *Wurlitzer* constitutes binding precedent on all members of the Court (*Foss v City of Rochester*, 66 NY2d 872, 873; *People v Hobson*, 39 NY2d 479, 489-490).

In any event, the State Tax Commission here expressly found that "a proper reflection of * * * New York franchise tax liability is impossible without combination." This conclusion is plainly rational (*see*, 20 NYCRR 6-2.3[c]). Petitioner and its related corporations have substantial intercompany transactions, which demonstrate that they have a symbiotic relationship to each other and that petitioner is a vital link in the overall enterprise. Moreover, since its inception, petitioner has exclusively solicited sales for Campbell's Soup in 34 states.

Finally, it was incumbent upon petitioner to establish that the allocation formula utilized by the Commission does not properly reflect the business it transacts in New York (*Matter of Eastman Kodak Co. v State Tax Comm.*, 33 AD2d 298, 303, *affd.* 30 NY2d 558). That burden has not been met here.

Campbell Sales Co. v State Sales Tax Comm.
No. 145
JSK (dissenting)

For more than 30 years, Campbell Sales Company (Sales), a New York taxpayer (*see*, Tax Law §§ 208[2], 209[1]), had paid State franchise tax based on its income. Its parent, Campbell Soup (Soup), had not done business here and was not subject to the tax. Now, with no change in Sales' business or its relations with its parent, Sales is compelled to file a combined report with Soup and its subsidiaries, because they are part of a unitary business, thereby for the first time subjecting the income of Soup and its subsidiaries to New York State franchise tax.

Pursuant to Tax Law § 211(4) the State Tax Commission may require a New York taxpayer that owns or is owned by another corporation to report income on a combined basis, "provided . . . that no combined report . . . shall be required unless the tax commission deems such a report necessary, because of intercompany transactions . . . in order properly to reflect the tax liability under this article." Because the Tax Commission's position—now reinforced by the majority's incorrect assumption that a taxpayer may be forced to file a combined report simply because it is "part of a unitary business conducted by the entire group of corporations" (slip opn., p 2)—reads out of the statute the requirement that a combined report must be necessary "in order properly to reflect the tax liability under this article", I respectfully dissent.

The Tax Commission made no finding that, because of intercompany transactions, a combined report was necessary properly to reflect the tax liability of Sales.* To the contrary,

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* The majority suggests that the Commission made a specific factual finding that in this case a combined report was necessary properly to reflect tax liability. Quoting from the Commission's decision, the majority claims that the Commission "here expressly found that 'a proper reflection of . . . New York Franchise tax liability is impossible without combination.'" The full quotation, however, reveals that the Commission was

(footnote continued on next page)

the Commission apparently believed that it was not required to make such a finding and that it could require affiliated corporations to file a combined report on the basis of two other factors: "(1) whether the corporations are in substance part of a unitary business conducted by the entire group, and (2) whether there are substantial intercorporate transactions among the corporations." (*See*, Conclusions of Law of the Tax Commission.) Thus, the issue is not—as the majority states—whether there was substantial evidence, or could have been a rational conclusion, that combined reporting was necessary to correctly portray Sales' tax liability under article 9-A of the Tax Law. The agency did not reach its decision on this basis and our review is confined to the agency's basis for its determination (*see, Matter of Montauk Improvement v Proccacino*, 41 NY2d 913, *Securities & Exchange Commn. v Chenery Corp.*, 332 US 194, 196). The issue is whether a taxpayer can be compelled to file a combined report simply because it is part of a unitary business, or whether—as the statute says—the Commission first must find that, because of intercompany transactions, a combined report is necessary in order properly to reflect tax liability.

The Tax Commission's reasoning permits the Commission to order affiliated corporations to file a combined report whenever they engage in activities that "are related to the activities of the other corporations in the group" (20 NYCRR § 6-2.2[b]). The second requirement, that there be "substantial intercorporate transactions", adds nothing of substance, for affiliated corporations engaging in a "unitary business" will,

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(footnote continued from preceding page)

taking the position that a factual finding was unnecessary because unitary businesses must *always* be combined for tax purposes: "Where the businesses of corporations are so unified and interassociated (having due regard for their separate existences), a proper reflection of their New York Franchise tax liability is impossible without combination." Our Tax Law requires more.

almost by definition, have "substantial intercorporate transactions" (*see* 20 NYCRR § 6-2.3[c]). The Appellate Division majority was therefore correct in concluding that the Commission's "reasoning could require a combined report in every instance in which a unitary relationship existed." (111 AD2d 995, 997.)

The "unitary business" concept essentially reflects a constitutional limitation on a State's right to tax income arising out of interstate activities—even on a proportional basis—unless there is a minimal connection or nexus between the interstate activities and the taxing state. Thus, a state may tax a purported "unitary business" if at least a portion of it is conducted within the state, and if the business is in fact "unitary" in the constitutional sense. Chief among the factors relevant to the latter question, are requirements that there be some uniting bond of ownership or control and that between in-state and out-of-state activities "there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation" (*Container Corp. of America v. Franchise Tax Board*, 463 US 159, 166). Thus, the Commission's approach may well be constitutional. But New York by statute has chosen not to adopt a unitary business test (*cf.*, *Container Corp. of America v Franchise Tax Board*, 463 US 159, 167-168). Our tax law provides on its face that the Commission may not require a combined report unless necessary "in order properly to reflect the tax liability under this article", and this statutory threshold has not been met—indeed it was not even recognized—in the case at Bar.

Wurlitzer Co. v State Tax Commission (35 NY2d 100) is markedly different. There, the Court upheld the Commission's determination to require the taxpayer, Wurlitzer, to file a combined report including the net income of its subsidiary, Wurlitzer Acceptance (WAC). But WAC was a shell. After

receiving $2.5 million in capital from Wurlitzer in the form of accounts receivable, WAC went into the business of buying accounts receivable from Wurlitzer and collecting them. WAC had no employees. It paid Wurlitzer a "fee" and Wurlitzer employees performed the collection tasks, purportedly on behalf of WAC.

Here, by contrast, Sales acted as a sales representative or food broker for Soup's products; Soup also retained brokers elsewhere to render the same service. While wholly owned by Soup, Sales operated autonomously, with its own employees—more than 1,000 in number—its own payroll, bank accounts, facilities, and a recognized business from which it derived income and paid expenses. It is uncontroverted that Soup paid Sales percentage commissions that were at least as high as—and likely higher than—commissions paid to other food brokers. Thus, Sales' own taxable income was at least as great as that of an independent food broker would have been.

As the Appellete Division noted in *Wurlitzer*, "The key finding made by the Commission, which is dispositive of this case, is that WAC had no separate corporate autonomy and was, in reality, merely the finance department of a unitary business, Wurlitzer" (42 AD2d 247, 250). Therefore, "the Commission concluded that the computation of the tax liability of Wurlitzer and WAC in the combined report, properly reflects Wurlitzer's tax liability for franchise tax purposes" (35 NY2d at 103), and we agreed that the "Commission could properly conclude that separate reports would not accurately reflect the taxable income or the taxable liability" (*id.* at 105). The Court in *Wurlitzer*, having pointedly set out the facts indicating that WAC had no autonomous existence and having reached its conclusion "on this record" (*id.*), cannot be said to have held as a matter of binding precedent that the tax law no longer requires inaccuracy by virtue of the intercorporate transactions as a basis for imposing combined reporting (*see*, *People v Bethea*, NY2d , n*). "It is well settled that '[t]he language of any opinion must be confined to the facts

before the court' " (*People v Anderson*, 66 NY2d 529, 535 *quoting, Dougherty v Equitable Life Assur. Socy.*, 266 NY 71, 88).

Because the Commission failed to apply the correct standard, I would affirm the judgement.

Judgment reversed, with costs, and determination of the Tax Commission reinstated in a memorandum. Chief Judge Wachtler and Judges Meyer, Simons, Alexander, Titone and Hancock concur. Judge Raye dissents and votes to affirm in an opinion.

Decided June 3, 1986

Supreme Court—Appellate Division
Third Judicial Department

June 13, 1985 48726

In the Matter of

CAMPBELL SALES COMPANY,

Petitioner,

v

NEW YORK STATE TAX COMMISSION,

Respondent,

HARVEY, J.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court at Special Term, entered in Albany County) to review a determination of respondent which sustained a franchise tax assessment imposed under Tax Law article 9-A.

Petitioner is a New Jersey corporation authorized to do business in New York. It is a wholly-owned subsidiary of Campbell Soup Company (Campbell Soup), which is also a New Jersey corporation. Campbell Soup is not a New York taxpayer because it does not do business in New York or engage in any activity in New York which would require the filing of a franchise tax return.

Since 1941, pursuant to an agreement with the Department of Taxation and Finance, petitioner has calculated its New York franchise tax pursuant to a modified formula. That formula properly and adequately established the net income of petitioner generated by its activities in New York. For petitioner's report for fiscal year 1977, the Department chose

not to honor its past agreement and required a combined return of petitioner with its parent corporation. Petitioner had reported and paid its calculated tax of $199,772. The Department determined under Tax Law § 211 (5) that an additional $540,000 was due. Had the statutory formula of Tax Law § 210 been used in computing the tax, petitioner would have been liable for the payment of $9,463.

Petitioner filed for redetermination of the claimed deficiency and for a refund of the amount of money it paid over and above that required by the statutory formula. The primary issue considered at the hearing was whether the Department properly required petitioner to file a franchise tax report on a combined basis with its parent corporation and seven other of Campbell Soup's subsidiaries.

Respondent's findings of fact included, *inter alia*, the following. Petitioner maintains 40 offices in 34 states, including two offices in New York. Campbell Soup is a manufacturer and processor of food and food products. Petitioner has been engaged in the business of acting as a sales representative or broker in the food business, soliciting orders for the products of Campbell Soup and its affiliates. The orders are transmitted to Campbell Soup's office in Camden, New Jersey, for acceptance and credit approval. The goods are then shipped directly from one of Campbell Soup's plants to the wholesaler or distributor, and payment therefor is made directly to Campbell Soup. During the year under consideration, petitioner had approximately 1,000 employees who worked exclusively for petitioner. In Alaska and Hawaii, petitioner retained food brokers to solicit orders for Campbell Soup's products. Petitioner also utilized brokers from time to time to solicit orders for new products. Petitioner pays its own expenses, most of which are to unrelated third parties. Petitioner's president, who works full time for petitioner, holds the office of vice president in Campbell Soup. Petitioner maintains its own books of account and bank accounts. Certain of petitioner's administrative functions, including the accounting and

legal functions, are performed for it by Campbell Soup. Petitioner is compensated by Campbell Soup on a cost-plus basis which, for New York in the taxable year, amounted to a commission of 2.74% of sales. The commission paid to petitioner by Campbell Soup is a fair and reasonable commission; if anything, the amount may have been more than would be paid for such work on an arm's length basis involving unrelated parties.

The Department allocated $6,218,807 as combined business income generated by petitioner in New York during the taxable year. This is in contrast to petitioner's total net income of $732,915, as reported in its Federal income tax return. The statement of audit and adjustment does not set forth the factors which were considered in arriving at the business allocation percentage which was applied. Neither does the decision make any explanation as to the manner in which the deficiency was computed.

The imposition of a franchise tax is "[f]or the privilege of exercising its franchise, or of doing business * * * in this state in a corporate or organized capacity" (Tax Law § 209 [1]). The requirement is that corporations subject to the tax "shall annually pay a franchise tax, upon the basis of [their] entire net income" (*id.*). Entire net income is defined by Tax Law § 208 (9) as a corporation's total net income from all sources and "presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department". If respondent were to determine that the reported net income computed in accordance with the statutory formula did not properly reflect the tax liability under the statute, it could resort to corrective adjustment of individual items by reallocation of income and deductions pursuant to Tax Law § 211(5). If that remedy were inappropriate, respondent is authorized to require a combined report. However, to have done so, respondent must have determined that such a report was necessary in order to properly reflect the tax liability under the statute (Tax Law § 211 [4]).

The actual net income of petitioner allocable to all its operations, as reported by petitioner in its Federal income tax return for the year in question, was $732,915. In its New York franchise tax return, petitioner reported its net income as $1,706,434. This was imputed from its willingness to report 4% of gross sales as reasonable net income for its services. There was no evidence of any nature to support the contention of the Department that the calculation of tax based upon the declared net income would improperly reflect petitioner's tax liability. On the contrary, there is no finding of fact contained within the decision which would explain and warrant the imposition of the additional tax. To accept the Department's conclusion would attribute to petitioner 36.14% of the total combined income of Campbell Soup and its subsidiaries.

Not only was there no basis in the record to substantiate that conclusion, logic and reason would dictate a contrary result. The activities carried on by petitioner throughout New York and other states were as a sales representative or broker. Petitioner contends, without contradiction, that food brokers serve their customers at low percentage commissions of sales. We must assume that selling to wholesalers, distributors or supermarket chains involves such large volumes as to permit a profitable operation remunerated at a relatively small percentage of sales.

Consequently, it is apparent that even if respondent was justified in requiring a combined report, there was no substantial evidence nor rational basis for the assessment of deficiency. It is our further view that there were no facts or circumstances requiring a combined report. Respondent relied upon a very narrow interpretation of the decision of the Court of Appeals in *Matter of Wurlitzer Co. v State Tax Comm.* (35 NY2d 100). Respondent interpreted *Wurlitzer* as granting it authority to require a combined report whenever it found a unitary business relationship to exist and without any further qualifications or restrictions. This interpretation is unjustified. The description of the statute as being unitary is

that of respondent and not of the Legislature. To adopt respondent's reasoning would require a combined report in every instance in which a unitary relationship existed. Were that so, the Legislature would have stated it without ambiguity and not left it to the determination of respondent as to whether a combined report was required. The facts of *Wurlitzer* are so different as to preclude respondent from any meaningful guidance in its determination of this case.

The purpose of the combined reporting provision of the franchise tax statute contained in Tax Law § 211 (4) is to avoid distortion of, and more realistically portray true income of, closely related businesses (*Matter of Coleco Inds. v State Tax Comm.*, 92 AD2d 1008, *affd.* 59 NY2d 994). No single factor is decisive in properly reaching a determination that requiring combined reporting fulfills the statutory purpose (*id.* at 1009).

It is obvious that respondent, by its determination, is endeavoring to tax the business activities of Campbell Soup in addition to the activities of petitioner.

> As a general principle, a State may not tax value earned outside its borders * * *. The broad inquiry in a case such as this, therefore, is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return" (*Asarco, Inc. v Idaho State Tax Comm.*, 458 US 307, 315 [citations and footnote omitted]).

The due process clause of the 14th Amendment requires that there be "a rational relationship between the income attributed to the State and the intrastate values of the enterprise" (*Mobile Oil Corp. v Commissioner of Taxes*, 445 US 425, 437). "[T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated" (*Container Corp. of Amer. v Franchise*

Tax Bd., US , , 103 S Ct 2933, 2942). Where a taxpayer can prove by clear and cogent evidence that the income attributed to a State is in fact out of all appropriate proportions to the business transacted in that state, the taxing authority's determination will not be permitted to stand (*id.*). Petitioner has met that burden here, while the formula used by respondent to determine petitioner's franchise tax liability under the combined reporting method is unsupported by substantial evidence in the record.

It is our conclusion that petitioner fully reported its net income on its franchise tax return and that there was no reasonable basis for the requirement that petitioner and its parent corporation file a combined return. Respondent, pursuant to Tax Law § 211 (5), had the authority to adjust the reported net income when, in its judgement, it determined that an agreement between two corporations created an improper loss or net income. It is readily apparent that respondent has for more than 20 years concluded that the agreement between petitioner and Campbell Soup has not truly reflected petitioner's net income. The instant franchise tax return computes net income at 4% of sales. That is in excess of the amount actually received by petitioner and in excess of the reasonable rate of commissions established by the evidence herein. There is no evidence in the record supporting the view that any sales broker dealing at arm's length with a food processor could negotiate a contract entitling it to net income of more than 4% of sales. Consequently, the assessment of deficiency must be annulled. On the other hand, petitioner's request for a refund of the amount it paid in excess of the statutory formula must be denied. Of its own volition, petitioner has reported what it has asserted to be its true net income and has thereby admitted that its contract with Campbell Soup does not truly represent the value to Campbell Soup of the services rendered by petitioner.

Determination annulled, with costs, and matter remitted to respondent for further proceedings not inconsistent herewith.

MAIN, MIKOLL and HARVEY, JJ., concur; KANE, J.P., and YESAWICH, JR., J., dissent and vote to confirm in the following memorandum by YESAWICH, JR., J.

YESAWICH, JR., J. (dissenting).

We respectually dissent. At issue is whether there is substantial evidence in the record to justify respondent's determination that a combined report is necessary to correctly portray petitioner's tax liability under Tax Law article 9-A.

Tax Law article 9-A proposes taxing foreign corporations doing business in New York on the basis of the business they generate in the State (Tax Law § 209 [1]; *Matter of Wurlitzer Co. v State Tax Comm.*, 35 NY2d 100, 105). To properly reflect that tax liability, Tax Law § 211 (4) authorizes respondent to require a foreign corporation to file a return combined with its parent if (1) the parent owns or controls substantially all of the capital stock of the taxpayer subsidiary, and (2) there are either substantial intercorporate transactions or some agreement which distorts income (*see also* 20 NYCRR 6-2.5 [a]; *Matter of Wurlitzer Co. v State Tax Comm., supra; Matter of Coleco Inds. v State Tax Comm.*, 92 AD2d 1008, 1009, *affd* 59 NY2d 994).

Since petitioner is a wholly-owned subsidiary of Campbell Soup, this appeal necessarily focuses on whether respondent acted rationally (*see Matter of Howard v Wyman*, 28 NY2d 434, 438; *Matter of Del-Mel Corp. v State Tax Comm.*, 102 AD2d 312, 313) when it concluded that petitioner and Campbell Soup engaged in intercompany transactions of substance, making proper reflection of their New York franchise tax liability impossible without a combined report. Significantly, respondent in appurtenant regulations, the validity of which is not challenged, has declared that in determining if there are material intercorporate transactions among corporations, activities such as the performance of services by the taxpayer for the other corporation and the selling of goods acquired from the other corporation are to be considered

(20 NYCRR ô-2.3 [c] [1], [2]). That regulation provides further that "[t]he substantial intercorporate transaction requirement may be met where as little as 50 percent of a corporation's receipts or expenses are from one or more" of such activities (20 NYCRR 6-2.3 [c]). To the exclusion of all else and since its inception, petitioner's complete and undivided attention has apparently been directed at soliciting sales for Campbell Soup in 34 states for over 60 years; that a substantial intercorporate relationship existed here is thus obvious.

The interassociation of these corporations is also manifested by the following undisputed facts: while petitioner sells Campbell Soup's products, Campbell Soup handles the advertising and marketing; after consummation of sales, petitioner continues to field and attempt to resolve customer complaints; employees of Campbell Soup will, on occasion, accompany those of petitioner to gather information for promotional materials and to ascertain the success of particular products; and the joint service of petitioner's president as vice-president of Campbell Soup.

Petitioner's contention that it is an independent enterprise is further undermined by (1) the priviate agreement with Campbell Soup which ensures that petitioner's income will equal its costs plus 4% and (2) petitioner's 1941 tax liability agreement with the State. The former agreement guarantees petitioner a profit regardless of cost fluctuations and actually results in increasing its income as its costs increase. This arrangement suggests that petitioner has a rather intimate involvement in the overall machinery of Campbell Soup's conglomerate. As for the tax liability agreement, it is so constructed that petitioner's gross income is arrived at only by allocating a portion of Campbell's Soup income to petitioner, and it even provides for readjustment of petitioner's income in the event that Campbell Soup's advertising expense falls below a certain amount. In short, by that agreement, the amount of income reported by petitioner is a product of Campbell Soup's income. Moreover, by reason of the tax liability agreement with the State, petitioner has since 1941 voluntarily paid New

York franchise taxes conspicuously greater in amount than those due under the statutory formula (*e.g.*, in 1977, $199,772 of tax paid under the agreement instead of $9,463 under the statutory formula), thereby implicitly acknowledging that its franchise tax liability is distorted if the New York income of the unitary business of which petitioner is a part is not considered. It is also worth noting that, absent such an agreement, unitary business income concededly derived by petitioner and Campbell Soup from New York would escape taxation. In our judgment, the foregoing evidence more than amply justifies respondent's decision to require a combined report.

With respect to the propriety of respondent's audit formula, the 1941 agreement, which neither party has a copy of, seemingly presupposes that 4% of Campbell Soup's sales revenue originated in New York. It is unchallenged that during the years 1974 through 1977, the sales of Campbell Soup within New York accounted for an average of 7.7% of its total sales; furthermore, during that time, the proportion of petitioner's total operating expenses to those incurred in New York, the multiplier for computing its New York source income under the 1941 tax liability agreement, averaged 9.46%. Consistent with these increases, for 1977, the year in question, the New York income of the unitary business is made up of the imputed New York income of Campbell Soup, 5.57% of its total sales revenue, and the actual income of petitioner, 2.51% of Campbell Soup's revenues. Inasmuch as petitioner has not maintained its burden of showing that the disputed allocation does not properly reflect the business transacted in New York, we would confirm respondent's determination.

Supreme Court, State of New York—Albany County

ORDER OF TRANSFER

AT a Special Term of the Supreme Court of the State of New York, held in and for the County of Albany, at the Courthouse, in the City of Albany, New York, on the 28th day of October, 1983.

PRESENT:

HON. LAWRENCE E. KAHN,
Justice.

In the Matter of the Application

of

CAMPBELL SALES COMPANY
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

-against-

NEW YORK STATE TAX COMMISSION,
Respondent.

ORDER OF TRANSFER

Index No. 13900/83

Upon reading and filing the notice of petition dated September 19, 1983, and the petition verified the 12th day of September, 1983, the answer and return of the respondent, and it appearing that one of the issues involved is whether the determination of the State Tax Commission made as a result of a hearing and at which evidence was taken pursuant to direction by law is, on the entire record, supported by substantial evidence, and due deliberation having been had,

NOW, Upon motion of Robert Abrams, Attorney General of the State of New York, attorney for respondent, it is ORDERED, that pursuant to section 7804(g) of the Civil Practice Law and Rules, the above-entitled proceeding be and the same hereby is transferred to the Appellate Division of the Supreme Court, Third Judicial Department, for disposition.

Dated: Albany, New York
October 28, 1983

Lawrence E. Kahn
J.S.C.

State of New York
State Tax Commission

In the Matter of the Petition of CAMPBELL SALES COMPANY for Redetermination of a Deficiency or for Refund of Franchise Tax on Business Corporations under Article 9-A of the Tax Law for the Fiscal Year Ended July 31, 1977.	DECISION

Petitioner, Campbell Sales Company, P.O. Box 391, Camden, New Jersey 08101, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the fiscal year ended July 31, 1977 (File No. 26893).

A formal hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 19, 1982 at 1:15 P.M., with all briefs to be submitted by October 19, 1982. Petitioner appeared by Whitman & Ransom, Esqs. (George Noumair, Esq., of counsel). The Audit Division appeared by Paul B. Coburn, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly required petitioner to file a franchise tax report on a combined basis with its parent corporation, Campbell Soup Company, and seven other Campbell Soup Company subsidiaries for the fiscal year at issue.

II. Whether petitioner is entitled to a refund in the amount of $190,309.00, representing the difference between the tax petitioner calculated and paid pursuant to a 1941 agreement with the Tax Commission and the tax which would have been due had petitioner calculated its tax under the statutory method.

FINDINGS OF FACT

1. On April 10, 1979, the Audit Division issued to petitioner, Campbell Sales Company, a Notice of Deficiency asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal year ended July 31, 1977 in the amount of $544,626.00, plus interest thereon. The Statement of Audit Adjustment, under the same date, explained that the deficiency was based on a field audit and set forth the following computation:

Combined entire net income per field audit	$152,747,499.00
Business allocation percentage per field audit	4.0713
Allocated business income	6,218,807.00
Tax at 10 percent	621,881.00
Subsidiary capital tax per field audit	1,159.00
Subtotal	623,040.00
20 percent surcharge	124,608.00
Surcharge credit	(5,000.00)
Minimum tax (7 subsidiaries)	1,750.00
Total tax	744,398.00
Tax per report	199,772.00
Deficiency	544,626.00

The asserted deficiency was reduced by a credit to Campbell Foods Distributing Corp. (sic) in the amount of $6,144.00.

2. Petitioner, a wholly-owned subsidiary of Campbell Soup Company ("Soup"), is a New Jersey corporation with its principal office in Camden, New Jersey. Petitioner maintains 40 offices in 34 states, including 2 offices in New York where it has been qualified to do business since 1941.

3. Soup is a manufacturer and processor of food and food products. Since its organization in 1922, petitioner has been engaged in the business of acting as sales representative or broker in the food business, soliciting orders for the products of Soup and Soup's affiliates. (Petitioner does not represent other food manufacturers because of the large volume of work it handles for Soup.) The orders are transmitted to Soup's offices in Camden for acceptance and credit approval. The goods are then shipped directly from one of Soup's plants to the wholesaler or distributor, and payment therefor is made directly to Soup.

4. During the year under consideration, petitioner had approximately 1,000 employees who worked exclusively for petitioner. In Alaska and Hawaii, petitioner retained food brokers to solicit orders for Soup's products. Petitioner also utilizes brokers from time to time to solicit orders for new products.

5. The compensation received by petitioner for the work that it does is governed by an agreement between petitioner and Soup entered into in 1947. There are no other agreements or understandings between petitioner and Soup regarding petitioner's income or expenses. The agreement provides for a payment to petitioner equal to petitioner's cost plus 4 percent thereof.

> "The Soup Company agrees to pay to the Sales Company for the services which shall be performed by the Sales Company under this Agreement, the actual net cost to the Sales Company of the operation and carrying on of the

business of the Sales Company so far as the same shall relate to the sale of the products above mentioned while this Agreement shall be in force and effect, including all salaries and wages of officers and employees of the Sales Company, all payments made by the Sales Company to The Prudential Insurance Company of America under the Campbell's Soups Retirement and Pension Plan, effective July 1, 1938, as amended, and all payments made by the Sales Company to The Travelers Insurance Company under the Campbell's Soups Group Life Insurance Plan, effective March 1, 1947; plus four (4) per cent of such actual net cost. . .".

The compensation paid by Soup to petitioner for each of the fiscal years 1954 through 1977, expressed as a percentage of Soup's sales generated by petitioner was as follows:

FYE July 31	Percentage	FYE July 31	Percentage
1954	2.0921%	1966	2.3769
1955	2.3572	1967	2.4164
1956	2.6862	1968	2.4295
1957	2.7520	1969	2.4785
1958	2.3505	1970	2.4752
1959	2.4290	1971	2.5253
1960	2.3796	1972	2.5937
1961	2.3790	1973	2.4802
1962	2.3057	1974	2.4165
1963	2.3398	1975	2.4735
1964	2.2702	1976	2.4851
1965	2.4143	1977	2.5112

The payments have been, for most years, the equivalent of a sales commission of 2 to 2½ percent. A 2 to 2½ percent commission for the work which petitioner does is a fair and reasonable commission and is not less than, and is probably more than, the equivalent of the amount that would be paid for such work on an arm's length basis involving unrelated parties. For example, in 1977, petitioner paid its broker in Hawaii a 2 percent commission on the sale of Soup's products.

6. Petitioner pays its own expenses (wages, salaries, rentals, etc.), most of which are to unrelated third parties.

7. Petitioner's president, who works full time for petitioner, holds the office of vice-president in Soup.

8. From time to time employees of Soup's marketing office accompany petitioner's employees on their routes to ascertain whether a particular product is selling well and to gather information for promotional materials.

9. Certain of petitioner's administrative functions, including the accounting and legal functions, are performed for it by Soup.

10. Petitioner maintains its own books of account and bank accounts.

11. (a) The sales of Soup and the amounts and percentages thereof made to New York customers for the years 1974 through 1977 were as follows:

Year	Total Sales	Sales To N.Y. Customers	Percent N.Y. Sales To Total Sales
1974	$1,229,936,937	$ 99,487,906	8.0889
1975	1,240,256,044	95,948,894	7.7362
1976	1,307,918,713	94,237,765	7.2052
1977	1,426,203,583	110,845,606	7.7721

(b) Petitioner's operating expenses and the portion thereof actually incurred with respect to New York for the years 1974 through 1977 were as follows:

Year	Total Expenses	Expenses Related To N.Y.	Percent N.Y. Expenses To Total Expenses
1974	$26,376,484	$2,500,974	9.4818
1975	27,152,042	2,783,962	10.2532
1976	29,102,837	2,676,431	9.1963
1977	32,605,526	2,915,653	8.9422

(c) The total amount paid by Soup to petitioner as a percentage of its sales everywhere, and the amount paid in

respect of New York sales as a percentage of New York sales for the years 1974 through 1977 were as follows:

Year	Compensation As A Percentage Of Total Sales	N.Y. Compensation As A Percentage Of N.Y. Sales
1974	2.4165%	2.7601%
1975	2.4735	3.0176
1976	2.4851	2.7978
1977	2.5112	2.7356

12. Since 1941, petitioner has calculated its New York franchise tax liability pursuant to a formula agreed upon (and modified in 1947) by petitioner, Soup and the Tax Commission. For purposes and in the implementation of this agreement, petitioner computes its gross income as 4 percent (adjusted in the event Soup's advertising expenses fall below 3½ percent of its sales) of Soup's total sales for the year, subtracts its expenses, and allocates the net income to New York in the proportion which petitioner's expenses incurred with relation to New York bear to petitioner's total expenses. Petitioner's computation of its tax liability for the fiscal year at issue is shown below.

(1) Campbell Soup Company sales			$1,327,379,763
(2) Amount computed thereon for apportionment purposes at agreed-on rate as follows: 4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%			
(a) Advertising expenses	$ 62,784,017		
(b) Sales	$1,327,379,763		
(c) Advertising expenses	$ 4.7%		
(d) Amount under 3½%	—		
(e) Agreed-on rate for period 8/2/76 to 7/31/77			4%
			$ 53,095,191
(3) Expenses of petitioner			32,605,526
(4) Amount computed for apportionment			$20,489,665
(5) Total expenses of petitioner (exclusive of state franchise taxes)	$32,387,204		
(6) Expenses incurred with relation to N.Y. (exclusive of franchise tax)	$2,697,293		
(7) Percentage relation of N.Y. expense to total expense			8.328268%
(8) Product of line (4) and line (7)			$1,706,434
(9) Tax at 10%			$ 170,654

Neither the Audit Division nor petitioner has a copy of the agreement. According to Paul Hellberg, a tax accountant with Soup responsible for preparing petitioner's franchise tax reports, "I was told this was agreed upon and you would do this . . . People who were around in '41 decided that is how we should file." According to the Audit Division, the agreement represented a recognition on the part of the corporations and the state that petitioner's New York franchise tax liability would not be properly reflected by filing on an individual basis under the statutory business allocation formula.

For the fiscal years 1970 through 1977, the tax which would have been computed under the statutory formula and the tax computed and paid by petitioner pursuant to the 1941 agreement was as follows:

FYE	Tax per Statutory Formula	Tax per Agreement
08/02/70	$ 6,408	$ 71,207
08/01/71	8,196	86,473
07/30/72	13,714	97,498
07/29/73	10,316	116,892
07/28/74	11,348	230,564
08/03/75	16,204	159,819
08/01/76	16,620	212,051
07/31/77	9,463	199,772

13. In April or May, 1977 (that is, 2 to 3 months prior to the expiration of petitioner's 1977 fiscal year), the Audit Division instituted a review of petitioner's method of calculating its tax liability. The corporation tax examiner requested and was granted access to petitioner's records for the years 1974, 1975 and 1976 and conferred with, among others, Mr. Hellberg. The examiner concluded that: (a) there was no basis upon which to continue the 1941 agreement; and (b) combined reports embracing Soup, petitioner and 8 other Soup subsidiaries should be required. On February 27, 1978, the examiner, other members of the Audit Division and petitioner's representatives met to discuss the Audit Division's

proposal for retroactive combined filing for the years 1974, 1975 and 1976. The Audit Division thereafter determined that combined reports would be required, but commencing with fiscal year 1977; it accordingly requested petitioner and Soup to supply the information needed to compute the tax on such combined basis.

Besides petitioner, the corporations the Audit Division sought to include in the combined report were as follows:

(1) Soup (incorporated in New Jersey in 1922)—the parent corporation.

(2) Joseph Campbell Company (incorporated in New Jersey in 1972)—a wholly-owned subsidiary of Soup which grows and purchases vegetables, all of which it sells to its parent.

(3) Champion Valley Farms, Inc. (incorporated in New Jersey in 1969)—a wholly-owned subsidiary of Soup which produces pet foods, all of which it sells to its parent.

(4) Valley Tomato Products, Inc. (incorporated in California in 1966)—a wholly-owned subsidiary of Soup which manufactures tomato paste, all of which it sells to its parent.

(5) Southeastern Wisconsin Products Company (incorporated in Wisconsin in 1965)—a wholly-owned subsidiary of Soup which sells food flavorings to its parent. All sales are to the parent.

(6) Campbell Soup Co. (Sumter Plant), Inc. (incorporated in South Carolina in 1965)—a wholly-owned subsidiary of Soup which manufactures frozen dinners and processes poultry. Approximately 70 percent of its sales are to the parent.

(7) Campbell Frozen Foods Distributing Co. (incorporated in New Jersey in 1955)—a wholly-owned subsidiary of Soup which purchases frozen dinners from the

parent and re-sells them to institutional customers under the name "EfficienC". All of its purchases are from Soup.

(8) Campbell's Soup Inter-America, Inc. (incorporated in New Jersey in 1969)—a wholly-owned subsidiary of Soup. This company is a Western Hemisphere trading corporation which sells Soup's products to Puerto Rico.

(9) Campbell's Export Sales, Inc.—a commission DISC for sales of its parent's products to points outside the United States.

The franchise tax asserted to be due from each of the corporations (excepting the DISC) was as follows:

Corporation	Tax
Campbell Soup Company*	$ 743,048
Campbell Sales Company	(199,522)
Campbell Frozen Foods Distributing Co.	(5,454)
Southeastern Wisconsin Products Company*	250
Valley Tomato Products, Inc.*	250
Campbell Soup Co. (Sumter Plant), Inc.*	250
Joseph Campbell Company*	250
Champion Valley Farms, Inc.*	250
Campbell's Soup Inter-America, Inc.*	250
	$ 539,752

* Previously not a N.Y. taxpayer.

14. Petitioner maintains that the Audit Division's computation allocates (combined) business income to New York in the amount of $6,218,807.00 with the following results:

(a) Petitioner's "imputed" gross income for fiscal year 1977 was $107,276,598, representing 8.08 percent of the parent's sales.

(b) Petitioner's "imputed" net income was $74,671,000, representing 69.6 percent of its gross compensation and 36.14 percent of the parent's pre-tax consolidated net income.

(c) The ratio of petitioner's "imputed" net income to its actual net worth is 2,220 percent. (The ratio of petitioner's actual net income to its actual net worth is 21.7 percent.)

This argument turns upon the assumption that the Audit Division imputed the combined income of the 9 corporations to petitioner itself.

15. Included in petitioner's brief were 50 proposed findings of fact all of which have been, in essence, adopted and incorporated into this decision with the following exceptions: proposed findings 13 and 15, which incorporate several factual statements rendering it difficult to rule thereon, are rejected; proposed findings 38 and 48 are rejected as not established by the evidence.

16. Included in the Audit Division's brief were 12 proposed findings of fact all of which have been, in essence, adopted and incorporated into this decision, with the exception of proposed findings 1 and 6, which are rejected as not established by the evidence.

CONCLUSIONS OF LAW

A. That subdivision 4 of section 21 of the Tax Law, in pertinent part, provides:

"In the discretion of the tax commission, any taxpayer, . . . substantially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations . . . , may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; provided, however, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article."

In interpreting the above-quoted subdivision, the Court of Appeals held that this Commission is expressly empowered thereby to require a combined report because of intercompany transactions, where certain conditions are found to exist; and further, that "when the Commission acts pursuant to the power conferred by subdivision 4, it is not a condition precedent that the income or capital of the taxpayer be improperly or inaccurately reflected" since subdivisions 4 and 5 of section 211 cover separate situations. *Wurlitzer Co. v. State Tax Comm.*, 35 N.Y.2d 100, 105. Compare 20 NYCRR 6-2.5, effective for taxable years commencing on or after January 1, 1976. Finally, there is no requirement in the statute or the regulations promulgated thereunder that there exist any unfairness in the transactions between the affiliated corporations. *Wurlitzer Co., supra.*

B. That after the stock ownership or control requirement has been met, as is clearly the case here, the Commission, in determining whether to permit or require combined reports, considers the following two key factors: (1) whether the corporations are in substance parts of a unitary business conducted by the entire group, and (2) whether there are substantial intercorporate transactions among the corporations. 20 NYCRR 6-2.3. The substantial intercorporate transaction requirement is likewise clearly satisfied in the instant case. All of petitioner's receipts are derived from selling the products of its parent and sister corporations, under a written agreement with the parent in force since 1947, which accord guarantees petitioner a profit each year. Furthermore, petitioner is unquestionably part of a unitary business conducted by Soup and the other subsidiaries sought to be encompassed in the combined report by the Audit Division. Petitioner solicits sales only for the Campbell group, and the products of the group are sold only through petitioner's concerted efforts. Where the businesses of corporations are so unified and interassociated (having due regard for their separate corporate

existences), a proper reflection of their New York franchise tax liability is impossible without combination.

C. That petitioner's tax liability being properly reflected on a combined basis as aforesaid, petitioner is not entitled to a refund in the amount of the excess of its franchise tax as determined pursuant to the 1941 agreement over the tax as would have been determined on a separate basis pursuant to sections 208 and 210 of the Tax Law. The 1941 agreement was not a written agreement of the Tax Commission entered into under the authority granted by subdivision eighteenth of section 171; it is therefore not final and conclusive with regard to the franchise tax at issue herein. *Matter of Petrie Stores Corporation*, State Tax Comm., January 2, 1980.

D. That the petition of Campbell Sales Company is hereby denied, and the Notice of Deficiency issued on April 10, 1979 is sustained in full.

DATED: Albany, New York STATE TAX COMMISSION

May 20, 1983

Roderick Chu
President

Francis R. Koenig
Commissioner

Mark Friedlander
Commissioner